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BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

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Madam Chairwoman Kelly, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify in this hearing on "Oversight of the Department of the Treasury." In your letter of June 4, 2004, you asked that I specifically address the following areas: (1) the results of our study of Bank Secrecy Act (BSA) compliance efforts by the Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), the Internal Revenue Service (IRS), and other regulators; (2) my opinions regarding OCC and OTS oversight of private banking practices and trust accounts in the area of BSA compliance; (3) whether the Financial Crimes Enforcement Network (FinCEN) database is in a form that permits efficient use by other agencies; and (4) any concerns I may have from our study of the Office of Foreign Assets Control (OFAC) foreign sanctions program.

My testimony will cover each of those areas. First, I would like to provide some background about my office. We provide independent audit and investigative oversight of the Department of the Treasury which includes numerous Departmental offices and activities as well as the 8 non-IRS bureaus. Our oversight includes Treasury's financial institution regulators—OCC and OTS, as well as FinCEN and OFAC. The Treasury Inspector General for Tax Administration (TIGTA) provides audit and investigative oversight of the IRS, another bureau with significant BSA regulatory responsibilities.

I consider our oversight of Treasury's role in combating terrorist financing, money laundering, and other financial crimes to be among our highest priority work. In fact, we designated this area as one of Treasury's 6 most significant management challenges. Accordingly, we have conducted a number of audits over the past several years as our limited resources have allowed. We started conducting audits in this area well before September 11, 2001. A list of these audits is provided as an appendix to my statement. We also currently have several audits in process. While it is evident from our work that Treasury takes its responsibilities very seriously, in almost every area we have audited we have identified problems significant enough to impact Treasury's ability to effectively carry out its role in combating terrorist financing and money laundering. This role is not only important for fighting crime and preserving the integrity of our financial institutions, but in the wake of September 11th, it has become increasingly vital to help preserve our national security.

Having said that, I must add that we have not been able to comprehensively audit all the important pieces that comprise Treasury's responsibilities in this area, nor have we been able to provide timely follow up to ensure previously identified problems were corrected. Moreover, our ability to oversee this important area going forward will be even more limited as a result of the divestiture of 70 percent of our resources to the Department of Homeland Security. We are now a small office of less than 100 and while we consider this area to be high priority, we have a number of statutorily mandated audits and many other high priority Treasury programs and operations to cover.

BSA Compliance Efforts at OTS, OCC, IRS, and Other Regulators

In discussing the results of our audit work in this area I want to reiterate that we do not have audit oversight or investigative authority over the IRS. Oversight of the IRS is the responsibility of TIGTA. We also do not have oversight of the other regulators such as the Federal Reserve or the Federal Deposit Insurance Corporation (FDIC). However, we have discussed our work with TIGTA and the other regulators' Offices of Inspector

General (OIG) and, in fact, a recent BSA audit that FDIC's OIG performed was patterned after the work that we had done at OTS.

In one of our earlier audits (January 2000), we reported that OCC needed to improve its BSA compliance exams. At that time, we found that many of the BSA compliance exams in our sample lacked sufficient depth to adequately assess a bank's compliance. Specifically, in 38 of the 82 examinations we reviewed, OCC examiners did not perform a complete BSA compliance exam – that was more than 45 percent of the exams we sampled. Of the exceptions, we found that: (1) for 17 examinations, OCC examiners failed to review one or more available bank-generated reports useful in identifying suspicious activity, such as the incoming and outgoing wire transfer logs; (2) for 10 examinations, OCC either did not follow-up on indicators of suspicious activities, perform sufficient review of high-risk accounts, adequately follow-up on prior examination exceptions, or take action when prior exceptions continued to exist; and (3) for the other 11 incomplete examinations, the weaknesses ranged from not verifying a banks' hiring process to not citing a bank for an incomplete BSA policy. In addition to incomplete examinations, we found that, for 44 of the 82 examinations – more than 50 percent of the exams we sampled – examiner workpaper documentation was insufficient to determine the extent or the adequacy of the BSA examination. We attributed the incomplete examinations to two major factors. First, OCC examiners relied on bank management and/or the bank's internal audit function instead of performing their own reviews. Second, OCC seemed to emphasize timely completion of examinations, at the expense of more complete examinations.

We made two other important observations in that report:

- OCC rarely referred BSA violations found by its examinations to FinCEN to assess monetary penalties. Over an 11-year period through 1998, OCC had referred only 53 BSA cases to FinCEN, or an average of less than 5 cases a year. No BSA violations were referred to FinCEN in 1997. We have some

additional observations on referrals to FinCEN that we will be discussing later in this testimony.

- OCC procedures for BSA examinations at community banks did not require examiners to review suspicious activity reports (SAR) filed by the bank. For large banks, a review of filed SARs was only required in certain circumstances. Filling this gap in BSA examination procedures would serve to strengthen OCC's BSA compliance program. An analysis of SAR information would enable OCC examiners to determine (1) whether the bank was filing SARs, (2) whether the bank filed SARs timely, and (3) whether the volume of SARs filed by the bank seemed low given the characteristics of the bank.

In response to our findings, OCC committed to communicating the results of our audit to its examiners, issuing additional guidance, and monitoring compliance with BSA examination procedures through periodic quality assurance reviews. However, OCC did not fully commit to reviewing SAR filings as a standard BSA examination procedure. Instead, it planned to adopt new procedures that would place "greater emphasis on SAR reporting." We have not followed up on this work. It should also be noted that the scope of this audit did not include a review of the adequacy of OCC enforcement actions for BSA violations.

We did, however, recently (September 2003) look at OTS' enforcement actions for BSA violations. The overall results of that audit showed that OTS was not aggressive in taking enforcement actions when thrifts were found to be in substantial non-compliance with BSA requirements. Specifically, while OTS examiners identified substantive BSA violations at 180 of the 986 thrifts examined during the audited period, OTS issued written enforcement actions against only 11.

In our review, we sampled 68 of the remaining 169 thrifts with substantive BSA violations where written enforcement actions were not taken by OTS. We found that for those thrifts, OTS primarily exercised moral suasion and relied on thrift management

assurances to comply with the BSA. This approach failed for 21, or more than 30 percent of the thrifts sampled. That is, the 21 institutions did not correct the violations, which in some cases went back more than 5 years. In some instances, subsequent examinations found that BSA compliance actually worsened from the time the violations were first identified. OTS should have clearly taken more forceful and timely enforcement actions against these thrifts.

Our audit also reviewed, in detail, 9 of the 11 cases where OTS did issue written enforcement actions. In 5 cases, we found that OTS either did not take timely enforcement actions or did not address all the substantive violations it identified. Moreover, for 2 of these 5 cases, the enforcement actions taken by OTS were not effective in correcting the violations identified.

In its response to our report, OTS, among other things, agreed to issue additional guidance to its examiners. We have not followed up on this work. It should be noted that OTS also stated in its response that our report demonstrated that the thrift industry and OTS supervision on the whole had achieved a record of sound BSA compliance. Our audit reached no such conclusion.

BSA Compliance Oversight of Private Banking Practices and Trust Accounts

With regard to oversight of BSA compliance over private banking and trust account services offered by national banks, we completed an audit of OCC's BSA examination program relative to these services in November 2001 (the work was performed prior to 9/11). Overall, in that audit we found that OCC needed to focus greater attention on its BSA compliance exams in the high risk areas of private banking and trust account services.

Among other things, OCC's BSA compliance exams at national banks did not always include the banks' private banking and trust account services. In a sample of 20 BSA compliance exams performed at banks offering private banking services, we found that

12 – 60 percent of the exams in our sample – did not cover the banks' private banking services. Similarly, in a sample of 34 BSA compliance exams at banks with trust account services, we found that 6 – 18 percent of the exams in our sample – did not show evidence of BSA compliance examination coverage. While trust account services may pose a lower risk than private banking services for possible terrorist financing and/or money laundering, these 6 banks alone had trust assets exceeding $67 billion.

We also found that in 28 BSA compliance exams sampled where there was evidence that OCC examiners reviewed BSA compliance over private banking or trust account services as part of their exam, 9 – or more than 30 percent of the exams sampled – did not fully comply with OCC's own BSA examination guidelines. We identified examinations where either the wrong examination handbook was used or examiners did not perform mandatory examination procedures.

That audit also found that BSA compliance exams lacked sufficient testing of high-risk transactions commonly associated with money laundering or lacked review and evaluation of critical BSA reports that banks are required to file. Specifically, examiners tested wire transfers in only half the examinations, and even fewer examinations included testing of transactions with foreign correspondent banks, currency transaction reports, or SARs. Transaction testing in high-risk areas is necessary to reliably assess BSA program compliance and to provide some assurance that bank-wide internal controls are working as intended.

In our report, we recommended that OCC (1) require coverage of private banking and trust account services in all BSA compliance exams, (2) ensure examiners complete all mandatory examination procedures, and (3) ensure examiners perform testing in all high risk areas. OCC responded that it would take steps to address these recommendations. We have not followed up on this work.

FinCEN's Database

With regard to FinCEN's database, we have completed two audits on the accuracy of FinCEN's BSA database for SARs, and we have a follow-up audit in progress. Overall, we have consistently found that the SAR database lacked critical information or included inaccurate data. SAR data is considered critical to law enforcement agencies (LEA) in identifying money laundering and other financial crimes. The events of September 11th only increase the importance of SARs for use in tracing financial crimes and transactions used to finance terrorist activities.

FinCEN established the SAR database in 1996 as a single collection point for all SARs to provide LEAs with critical information to enable comprehensive analyses of trends and patterns in financial crime activity. FinCEN operates and maintains the SAR database through IRS' Detroit Computer Center (DCC). Financial institutions and other required SAR filers can file SARs via paper or electronically.

In December 2002, we reported that regulatory and LEA officials (Federal Bureau of Investigation, United States Secret Service, and IRS) we interviewed believed the SAR database was very useful in identifying suspected bank-insider abuse and BSA violations. However, they indicated that the usefulness of the SAR database would be enhanced if it included more complete and accurate SAR data. At that time, we found that the SAR database sometimes lacked critical information or included inaccurate data because SAR filers disregarded SAR form instructions, did not always understand the violations listed on the SAR form, or were concerned with personal liability. Some illustrative examples follow:

- One LEA provided 6-month statistics documenting about 2,400 SARs involving $178 million in losses where the suspected violation was not indicated. SAR filers often filed under "other" instead of a specific violation even when the filer was reporting a known violation, such as money laundering.

- One LEA's database of downloaded SARs included 500 that did not identify the regulator. SAR filers did not always indicate their regulator on the SAR.

- A critical field on the SAR form is the filer's narrative description of the suspicious activity; some SARs did not include this narrative. Instead the filer included a "see attached" – the attachment was not captured in the database.

- SARs did not always accurately indicate the location where the suspicious activity occurred. Instead, the SAR database included the office location from where the SAR was filed rather than the branch or office where the reported violation occurred.

- At the time, there were also about 3,300 duplicate SARs in the database.

We also reported that IRS DCC contractor personnel sometimes made keypunch errors and omissions while inputting data from paper SARs. These errors and omissions were not always corrected.[1]

Although FinCEN personnel told us during the audit that they believed progress had been made in improving SAR accuracy, officials from both FinCEN and IRS DCC agreed there was still an on-going problem with SARs having missing and incomplete data and were working to identify and correct these problems. FinCEN officials believed the SAR database contained missing and incomplete data because SAR filers make human errors. FinCEN personnel also stated they were working to improve the data in the SAR database by proposing additional manual and system edits and data perfection routines, communicating with filers regarding invalid and missing data, and enhancing outreach efforts. The major objective of the enhanced outreach program would be to focus on the accuracy of the SARs filed.

[1]These deficiencies were similar to those found and reported on in our previous January 1999 audit.

We recommended in our report that FinCEN, in coordination with IRS DCC and the Federal regulators: (1) implement procedures to increase editing, mandatory data, and feedback with financial institutions and regulators, (2) revise the SAR form or find other means to address the problems with narrative write-ups and identifying violations, and (3) eliminate duplicate SARs in the system. Due to the importance of reliable SAR data to FinCEN's core mission and these repeated deficiencies, we also recommended that FinCEN consider designating SAR accuracy as a material weakness under the Federal Manager's Financial Integrity Act (FMFIA). In its response to our report, FinCEN concurred with the reported findings and indicated that it would complete a series of actions to improve its SAR database by June 2003. However, FinCEN did not agree that the inaccuracies in the SAR database identified in our report warranted reporting as an FMFIA material weakness.

In its response to our report, FinCEN also provided its view that the responsibility for the accuracy of SAR data is shared with the 5 Federal regulators (OCC, OTS, Federal Reserve, FDIC, and National Credit Union Administration). In this regard, FinCEN asserted that the Federal regulators are also owners of the SARs with equal responsibility for the issues raised in our audit, and that FinCEN was bound by agreements with the regulators, which required their concurrence on SAR issues. In our view, this statement highlights a fundamental problem in the existing regulatory regime for BSA. That is, responsibility, and therefore accountability, for the administration of the BSA has been dispersed both within and outside the Treasury Department. We are unaware of any legislative requirement that FinCEN is required to obtain concurrence by the Federal regulators on SAR issues.

We considered the accuracy of SAR information so important to law enforcement that we began a follow up audit in July 2003 to assess FinCEN's progress in implementing its planned corrective actions to our December 2002 report. The scope of that work entails assessing the accuracy of a sample of SARs filed between November 2002 and October 2003. We interviewed LEAs to identify those fields on the SAR form they consider critical to (1) develop an investigative case or (2) conduct trend analyses for

intelligence or policy assessment purposes. These are the fields we are testing in our sample.

While that audit is in progress, we are once again finding problems with accuracy of the SAR database. The problems include: (1) missing information – data fields left blank; (2) incomplete information – data fields partially completed; (3) inappropriate information – clearly erroneous data; and (4) inconsistent information – conflicting data. We are currently discussing our sample results and other findings with FinCEN management and expect to complete this audit later this fiscal year.

Before I discuss my concerns with OFAC's foreign sanctions program, I want to briefly comment on some work we have done on referrals by regulators to FinCEN and FinCEN's enforcement actions on those referrals. Our work in this area is limited. Having said that, in October 2002 we completed an audit of FinCEN's efforts to deter and detect money laundering in casinos and its related enforcement actions. It should be noted that the IRS is responsible for performing BSA compliance exams of casinos.[2] Overall, we found that FinCEN was inconsistent and untimely in its enforcement actions against casinos for BSA violations referred by the IRS.

In that audit we looked at 28 BSA violation referrals to FinCEN. For 7 of the referrals – 25 percent of those in our sample, FinCEN either issued warning letters or took no enforcement action. The potential civil monetary penalties that could have been assessed for these 7 referrals exceeded $8 million. At that time, FinCEN was embarking on a new enforcement philosophy focused on fostering casino compliance through education and industry outreach, with civil penalties imposed in the more egregious cases. FinCEN urged IRS to develop procedures to support its new philosophy. We found that IRS officials did not agree with several aspects of this new enforcement philosophy but their concerns were not resolved. As a result, we reported that the IRS might be reluctant to refer future casino BSA violations to FinCEN. Our

[2]There is one exception to IRS's BSA compliance exam authority -- Nevada casinos are examined by the State of Nevada pursuant to a May 1985 memorandum of agreement with Treasury.

concern was reiterated by TIGTA in its March 2004 report on IRS' BSA compliance program covering both money services businesses and casinos. In that report, TIGTA noted that of approximately 3,400 IRS compliance exams during fiscal year 2002, only 2 BSA violations were referred to FinCEN for civil penalty consideration. Based on discussions with IRS personnel, TIGTA concluded that there was a perception among examiners that there was no need to refer cases to FinCEN because FinCEN did not assess penalties. FinCEN officials, on the other hand, told TIGTA that, because of poor case documentation and inadequate evidence, the referred cases did not provide the information necessary for assessing penalties. If such a perception exists between FinCEN and the regulators on the matter of referrals, it could impair the quality and timeliness of enforcement actions necessary to carry out an effective BSA program. We have not followed up on this work.

OFAC Foreign Sanctions Program

The last area you asked me to address is our concerns with OFAC's foreign sanctions program. We completed an audit of OFAC in April 2002. Overall, we found that OFAC was limited in its ability to directly monitor financial institution compliance with foreign sanction requirements. While OFAC devoted considerable effort to compliance outreach in the financial community to enhance the awareness of foreign sanction requirements, it, like FinCEN, is dependent on the financial institutions regulators to examine compliance. Our testing has found gaps in OFAC examination coverage by the regulators.

Specifically, OFAC primarily relies on authority established under the Trading With the Enemy Act (TWEA) and the International Emergency Economic Powers Act (lEEPA). Neither TWEA nor IEEPA provide OFAC with the authority to test a financial institution's compliance with foreign sanction requirements. Unless OFAC is made aware that a prohibited transaction was allowed/occurred, or that there is a blockable interest, OFAC cannot examine the transactions of a financial institution. Also, the Right to Financial Privacy Act (RFPA), with some exceptions, does not allow financial institution regulators

to share the financial records of the institutions they supervise with OFAC because OFAC is not a bank supervisory agency.

As a result, OFAC must rely on the financial institution regulators' examination process to monitor financial institution compliance with foreign sanctions. This process may not provide adequate assurance that financial institutions are complying with the requirements of the various foreign sanctions. While we have not comprehensively audited OCC and OTS' OFAC compliance examination programs, as part of this audit we looked at 15 OCC compliance exams and 4 OTS compliance exams to assess the procedures used by examiners in determining foreign sanction compliance. Of the 15 OCC examinations, 2 exams did not address OFAC processes and controls at all. Furthermore, only 2 of the other 13 exams included any transaction testing even though examiners identified OFAC deficiencies at 4 other banks where transaction testing was not done. None of the 4 OTS compliance examinations included any transaction testing for OFAC programs although examiners noted OFAC deficiencies at 1 thrift. Transaction testing -- testing individual financial transactions for compliance with foreign sanctions -- is necessary to determine whether a prohibited transaction had been allowed/occurred.

Also, because OFAC is not a bank supervisory agency it cannot dictate the requirements for financial institution compliance programs. We found that, based on a survey of financial institutions, the extent of foreign sanction compliance efforts varied. Of the 102 financial institutions that responded to our survey:

- 26 financial institutions, including 17 large institutions (institutions exceeding $1 billion in assets) reported that they did not use interdict software (a useful automated electronic application) to detect prohibited transactions.

- 16 financial institutions, including 13 large institutions, reported that they had not specifically designated a compliance officer to handle sanction issues.

- 8 financial institutions reported that their compliance programs did not include written procedures and guidelines for examining financial transactions for prohibited countries, entities, and individuals.

In addition, we found that OFAC had limited assurance that statistical reports on sanction activities captured complete, reliable, and timely information. Specifically, we found instances where procedures were not established, databases were not updated, and guidance was not followed in (1) processing blocked and rejected financial transactions, (2) reporting on blocked assets, (3) reviewing license applications, and (4) assessing civil penalties.

We recommended in our report that Treasury inform the Congress that OFAC lacked sufficient legislative authority to ensure financial institution compliance with foreign sanctions. Also, we recommended that Treasury inform the Congress that OFAC's ability to ensure financial institution compliance with sanctions would be enhanced by providing for the bank regulators to share pertinent information that comes to their attention with OFAC. This could be accomplished by amending the RFPA to include OFAC in its definition of a "bank regulator" for the purpose of sharing information with OFAC. We also provided a number of recommendations to improve reporting of blocked and/or rejected financial transactions.

In its response to our report, OFAC management took exception to our finding that legislative constraints hampered its ability to monitor financial institution compliance. However, OFAC did not provide any additional information to support its position. OFAC did agree that current legislative authority could be improved with regard to Federal bank regulators sharing information and that increased oversight and detailed account reviews by regulators could be beneficial. We have not followed up on this work.

In concluding my testimony, I would like to make a few observations. The intent of BSA, expanded by the USA PATRIOT Act, is to provide law enforcement with information on

currency transactions and suspicious financial activity to help it identify and combat terrorist financing, money laundering, and other financial crimes. For that information to be of maximum benefit, it must be complete and accurate, and made available to law enforcement as soon as possible. In the current structure, FinCEN is dependent on many Federal and non-Federal regulators to monitor BSA compliance. Ultimately, however, it is Treasury's responsibility, through FinCEN to ensure that law enforcement is getting the information it needs and that it is timely and useful. In this regard, we believe the Department can do a better job.

Our work, and that of other OIGs, has shown gaps in compliance monitoring by the regulators. As I discussed earlier, OCC did not always do a thorough job of determining whether financial institutions had adequate BSA programs, and OTS did not always effect compliance when it found BSA violations. The FDIC OIG and TIGTA have identified problems with BSA compliance monitoring at their agencies as well. We also found that information contained in the BSA reports coming into FinCEN were oftentimes less than the law *requires*, yet these reports were accepted with little consequence to the filer. The universe of required BSA filers is expanding as more opportunities are identified for moving money through our financial markets. This will result in dispersing BSA compliance monitoring among even more regulatory bodies.

One of FinCEN's challenges has been ensuring that the regulators of these various industries provide adequate and effective BSA compliance monitoring. To this end, FinCEN's approach to BSA administration has been focused on consensus building rather than leading, an approach that has met with limited success. I believe that for the current regulatory structure to work, it must be effectively managed through a cohesive effort that transcends the stovepipes of the individual regulators. FinCEN needs to take a more aggressive leadership role in that effort and require from all those involved in the regulatory structure an approach that, while risk-based, is thorough and intolerant of noncompliance. FinCEN also needs to be more engaged in analyzing the results produced by the various regulators so that it can be more proactive in addressing gaps

in compliance monitoring. Finally, FinCEN needs to be more assertive in using its authority to levy monetary penalties for noncompliance with BSA requirements.

This type of approach would also apply to programs for which OFAC is responsible since it also relies on other regulators to administer its programs. The newly created Treasury Office of Terrorism and Financial Intelligence (TFI), to which FinCEN and OFAC will report, can be the vehicle to pull this all together and establish a regulatory structure for BSA and the OFAC sanction programs that is strong, effective, and accountable.

This concludes my testimony; I would be pleased to answer any questions the Subcommittee may have.

APPENDIX

Department of the Treasury Office of Inspector General
Recent Reports Related to Compliance Monitoring and Enforcement of
The Bank Secrecy Act and Office of Foreign Assets Control Sanction Programs

Compliance Monitoring and Enforcement of the BSA

Office of the Comptroller of the Currency (OCC) Bank Secrecy Act Examinations Did Not Always Meet Requirements; OIG-00-027, issued January 3, 2000

BANK SECRECY ACT: OCC Examination Coverage of Trust And Private Banking Services; OIG-02-016, issued November 29, 2001

MONEY LAUNDERING/BANK SECRECY ACT: FinCEN Needs To Strengthen Its Efforts To Deter And Detect Money Laundering In Casinos; OIG-03-001, issued October 1, 2002

FinCEN: Reliability of Suspicious Activity Reports; OIG-03-035, issued December 18, 2002

OTS: Enforcement Actions Taken for Bank Secrecy Act Violations; OIG-03-095, issued September 23, 2003

Compliance Monitoring and Enforcement of OFAC Foreign Sanction Programs

FOREIGN ASSETS CONTROL: OFAC's Ability To Monitor Financial Institution Compliance Is Limited Due To Legislative Impairments; OIG-02-082, issued April 26, 2002